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STATE PASS USTR FOR B. WEISEL AND J. JENSEN
COMMERCE FOR JENNIFER BAKER

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TAGS: ETRD MY
SUBJECT: MALAYSIA'S PROPOSED GUIDELINES ON FOREIGN
INVESTMENT IN DISTRIBUTIVE TRADE SERVICES

REF: KUALA LUMPUR 331

Summary and Introduction

¶1. (SBU) Summary: The Ministry of Domestic Trade and Consumer Affairs (MDTCA) - the Malaysian ministry which regulates all distributive trade - recently proposed sweeping new regulations which would increase the cost of doing business in Malaysia for all firms in distributive trade. The new rules include increases in paid up capital, requirements to offer 30% equity to ethnic Malays, and, in some cases, creation of a separate marketing arm for foreign manufacturers operating in Malaysia. The regulations were initially announced in December 2004 without any comment from affected industry or other Malaysian ministries. Due to public outcry, MDTCA has since allowed for a comment period and says it will accept some changes. MDTCA intends to submit the amended rules to the cabinet in April or May for implementation in mid-2006. The AmCham has declared these new regulations to be a step back from recent trade liberalization policies championed by MITI and MIDA which will send the wrong signal to foreign investors. The new rules are also likely to become an issue in the upcoming Free Trade Agreement negotiations. We believe that there may still be an opportunity to influence GOM thinking, and post recommends that Deputy Secretary of Commerce Sampson address these issues with MDTCA during his visit in April. End Summary.

¶2. (SBU) The Ministry of Domestic Trade and Consumer Affairs is finalizing the adoption of regulations to govern foreign participation in Malaysia's distributive trade services sector, which includes wholesale and retail operations. The new guidelines would supersede a previous set of regulations that date to 1995. The revised guidelines were first announced in December 2004, apparently without input from the foreign business community. Since then foreign businesses have weighed in at various levels with the government, including the National Economic Action Council in the PM's office. The MDTCA eventually acquiesced to hearing the views of the foreign business community as well, which have criticized the guidelines as being a step backward from Malaysia's efforts to attract more foreign investment. The resulting amendments to the 2004 draft have alleviated some industry concerns, but the current draft retains provisions that could impact the ability and willingness of some foreign investors to do business in Malaysia.

¶3. (U) At a Malaysian Trade Distribution Forum in January 2006, Minister of Domestic Trade and Consumer Affairs Shafie Apdal emphasized the important role that the retail trade

sector plays in developing Malaysia's economy and Malaysian entrepreneurship. Shafie noted that in 2005 the distributive trade sector contributed about 12 percent to Malaysia's GDP, providing employment for some 1.2 million people. He also noted that the sector is a key component of the government's efforts to increase Bumiputera (ethnic Malay) participation in the Malaysian economy. Shafie explained that the proposed regulations are aimed in part at protecting the livelihoods of smaller traditional retail businesses and building up Malaysia's small and medium enterprises (SMEs), in part by restricting the activities of large retail operations, including foreign ones. (Note: Shafie's highlighting both the importance of the distributive trade sector and the small entrepreneur is completely in line with current Malaysian economic policy. Over the past few years, the service sector has been the major engine for new economic growth and SMEs are seen as the drivers for that engine. End note.)

Proposed guidelines

¶4. (U) The guidelines proposed in December 2004 define distributive trade as "all linkage activities that channel goods and services down the supply chain to intermediaries for resale or to final buyers." They would apply to any business containing 15 percent or more foreign interest. Such businesses would need to obtain the approval of the inter-ministerial Distributive Trade Committee (DTC), chaired by the MDTCA's Secretary General, in order to begin operations, or to open new branches of an existing establishment. The guidelines are divided into the following categories: hypermarkets, departmental stores, superstores, specialty store, various other smaller distribution formats, direct sellers, and franchisors/franchisees. No foreign

involvement would be permitted in a variety of other distributive trade sub-sectors, including supermarkets, mini-markets, convenience stores, gas stations, newsagents, and medical halls. Under the December 2004 proposal, foreign manufacturers, even those with existing facilities in Malaysia, and including those with up to 100 percent foreign equity, would be required to set up a separate business entity to engage in any defined distributive trade, and the new entity would need to adhere to the guidelines as applicable.

¶5. (SBU) At all levels of distributive trade, the guidelines (as initially proposed) would require that all qualifying foreign direct investments (those exceeding the 15 percent threshold of total foreign equity) reserve at least 30 percent of equity for Bumiputeras (ethnic Malays). The guidelines also would impose minimum capital requirements ranging from RM 50 million (approximately USD 13.4 million) for hypermarkets down to RM one million (USD 269,000) for specialty stores and the various other smaller distribution formats in which foreign direct investment would be permitted. A distributive trade company with paid up capital of RM 10 million and above would be automatically allowed three expatriate key post positions, while those with paid up capital between RM one and RM ten million would be allowed one automatic expatriate key post, though exceptions to these limits would be considered on a case-by-case basis.

¶6. (SBU) In September 2005 and again in January 2006 the MDTCA issued CDT-approved amendments to the December 2004 draft guidelines. Among the changes were the implementation of a maximum three-year grace period for a defined foreign investment to meet the designated Bumiputera or local equity requirements; loosening the paid up capital requirement by applying it only to the headquarters of a new investment rather than to every new outlet deriving from the investment; and changing the 30 percent equity requirements for activities involving alcohol and non-halal food to apply to any local investor, not just Bumiputeras. The committee also reportedly approved an amendment that would exempt existing

manufacturing companies from the requirement to set up a separate marketing arm if they wished to engage in wholesale (but not retail) business.

Embassy Discusses Concerns with MDTCA

¶7. (SBU) On February 17, econoffs and econ specialist met with Mohd Talak bin Abu Bakar and Mizool Amir bin Mat Drus, Assistant Directors in the MDTCA's Domestic Trade Division, to raise our concerns regarding the proposed guidelines. Talak has been the Ministry's principal interlocutor with industry as well. Econoff observed that the government promulgated guidelines without the input (at least initially) of the foreign business community that would be so affected by them. The draft guidelines, even with the recently reported amendments, still appeared to be potentially damaging to Malaysia's attractiveness for foreign investment. Econoff added that U.S. industry had indicated particular concerns about the new minimum paid-up capital requirements, and about the requirements for manufacturers to set up separate entities to market their products in Malaysia. Industry is also concerned about the proposal to require hypermarkets to reserve 30 percent of shelf space, and 30 percent of all products sold, for B
umiputera products.

¶8. (SBU) Talak admitted that the MDTCA had not been transparent when it first promulgated proposed revisions to the guidelines, and said the ministry now was keeping industry better informed and involved in the process, pointing to the amendments that have been made to the December 2004 draft as proof. He said the government decided to issue a new set of guidelines in 2004 primarily to clean up the much amended 1995 guidelines, not because it saw a need for a new approach to foreign investment in the sector. Nevertheless, Talak pointed out that the new guidelines actually open up much foreign investment possibilities, as the earlier rules only allowed a maximum of 30 percent foreign investment in the retail sector, compared to 70 percent in the new guidelines. (Comment: Although the maximum possible equity may have been increased by 40% in some subsectors, it is difficult to see where such possibilities lie since much of the distributive trade sector is closed to foreign participation. In any case, the new regulations are not very accommodating to foreign direct

investment, as they add both cost and complexity to doing business in Malaysia. End Comment.) He added that in the last year the MDTCA also has been working more closely with the Ministry of International Trade and Industry (MITI) to ensure that the regulations would not impose a significant impediment to foreign investment.

¶9. (SBU) Talak noted that Minister Shafie Apdal had personally proposed several provisions in the draft guidelines, including the minimum paid up capital figure of RM one million. Talak explained that the capital requirements (which for a similar local business with less than 15 percent foreign equity are only RM 350,000) are designed to ensure genuine, high-quality foreign investment that would inhibit unscrupulous investors from making a quick buck in Malaysia's retail sector. Talak added that Shafie had decided to exclude restaurants from the guidelines, though it is unclear whether this exemption will be enshrined in the final regulations. Talak further pointed out that the 15 percent foreign equity threshold essentially exempted a significant chunk of foreign investment from the new guidelines.

¶10. (SBU) Talak also noted that MITI has proposed to MDTCA that foreign manufacturers licensed by MITI or the Malaysian Industrial Development Agency (MIDA) under the Industrial Coordination Act of 1975 should also be exempt from the proposed requirement to set up a separate marketing entity to

sell their products in Malaysia. Talak told us Minister Shafie Apdal has not yet made a decision on MITI's proposal. We understand another proposal would exempt manufacturers from this provision if they distribute their products through local distribution channels rather than through direct marketing of their products. Talak also told econoffs that Shafie has already lifted the January 2004 moratorium on hypermarket construction, anticipating that the new guidelines would alleviate the concerns of local retailers that had led to the moratorium in the first place. Another revision eliminates the proposed requirement that hypermarkets seek application for new branches at least two years in advance.

¶11. (SBU) The MDTCA is in the process of reviewing comments it has received from industry on the proposed guidelines and hopes to finish a final draft soon, according to Talak. The ministry currently plans to submit the guidelines for cabinet approval in April or May for implementation by mid-2006.

Embassy Actions and Proposal for Commerce

¶12. (SBU) The Ambassador also weighed in with MDTCA in a February 24 meeting with Minister Shafie Apdal, emphasizing that many of the measures that reportedly would be covered under MDTCA's new distributive trade regulations would run counter to what the U.S. would like to see in an FTA. The Ambassador suggested that MDTCA defer implementation of the new regulations pending a decision on the FTA negotiations. Shafie said he realized that the distributive trade regulations caused issues for some parties, but stressed that he is under considerable political pressure, including from other Cabinet members, to release them soon (see reftel for further detail on their meeting). As the guidelines have yet to be released, post recommends that Deputy Secretary of Commerce Sampson address these issues with MDTCA during his visit to Malaysia in late April. The Commercial Service has agreed to this suggestion and is waiting for confirmation of a meeting with Shafie Apdal.

AmCham's Position

¶13. (SBU) In a memo to the National Economic Action Committee at the end of October 2005, the AmCham stated their concerns with the proposed distributive trade rules, specifically: the requirement for manufacturing companies to establish a separate marketing arm with 30 percent bumiputera equity; the requirements on hypermarkets mandating that 30 percent of the products on the shelves must be bumiputera products and that 30 percent of total sales must be from bumiputera products; the lack of coordination between government ministries such as MITI and MDTCA that might produce overlapping and conflicting regulations; the lack of transparency in the process; and the lack of public comment prior to the unveiling of the new guidelines. AmCham was unequivocal in its declaration that the proposed guidelines

would have a negative impact on the foreign direct investment in Malaysia. AmCham was particularly alarmed by the retrospective rules which they believe would send unfavorable signals to the international investment community and call the credibility of Malaysia's policies into question.

¶14. (SBU) AmCham later presented these comments to MDTCA in a February 2006 meeting with a number of other international chambers. AmCham believes that this meeting was held so that MDTCA could say that it had coordinated with the international business community. AmCham was not heartened by its inability to get a private meeting with MDTCA Secretary General Talaat; in the past 8 months, he has

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canceled 4 or 5 scheduled meetings with the AmCham and

provided no explanation. Still, some industry sources are reporting that MDTCA has accepted some of the private sector's recommendations. For example, AmCham is cautiously optimistic that MDTCA will lift the proposed requirements for companies that entered under MITI or MIDA special incentives.

Unanswered Questions

¶15. (SBU) The draft guidelines raise several key questions that MDTCA officials were unable to answer. Talak did not express concern about whether the new guidelines might conflict with Malaysia's WTO TRIM obligations, noting that this was an issue for MITI to determine (inferring that MITI had not previously expressed any concerns in this regard). Some industry groups speculate that the government would have to impose identical guidelines on all Malaysian companies, not just those with 15 percent or greater foreign participation, in order to be WTO compliant. Many of the provisions that previously referred to thresholds for "Bumiputera" investors now just refer to "local" investors, which may be an attempt to address TRIM concerns.

¶16. (SBU) Another unanswered question is whether the guidelines would be enacted retroactively to cover existing foreign investments in the sector. MITI's proposal to exempt MITI- or MIDA-licensed companies apparently does not address whether new companies receiving such licenses from MITI or MIDA would also be exempt from the guidelines (should this proposal be approved by the MDTCA).

Comment

¶17. (SBU) Malaysia's efforts to implement guidelines on distributive trade exemplify the government's halting efforts to seek and utilize public input in implementing policy changes. To a certain extent the MDTCA has responded favorably when industry has complained about the guidelines' potentially negative effects on foreign investment. MDTCA also has been mindful of the prerogatives of other ministries, such as MITI's insistence that the new guidelines not inhibit those foreign investments that have been licensed by MITI or MIDA. Although the Ministry would probably point to these actions as evidence of its transparency, these changes clearly were not made through a transparent process that allows for the regular, predictable input of interested parties, both in and, especially, out of the government.

¶18. (SBU) MDTCA's proposed regulations likely would add to both the complexity and cost of doing business in Malaysia, for foreign and local companies alike. It is a step back from MITI and MIDA's more relaxed posture of recent years. Some of its provisions appear to contradict the GOM's goal of attracting increased foreign direct investment to Malaysia. Certainly, the rather arbitrary increases in paid up capital for current and prospective business send the wrong signal to foreign investors. While MITI may have convinced MDTCA to allow a grandfather clause for existing companies, new business ventures may still be obliged to operate under the new regulations and, therefore, would be required to apply to both the Foreign Investment Committee and the Distributive Trade Committee to obtain licenses and to offer 30% equity to ethnic Malays, with the resulting increase in overall business costs.

¶19. (SBU) The new regulations could raise issues that would need to be addressed as we prepare to negotiate the U.S.-Malaysia Free Trade Agreement (FTA). MDTCA has drawn a fairly firm line in the sand for allowable participation in a wide variety of distributive ventures. Furthermore, the ministry appears unwilling or unable to delay final approval

of the guidelines while we negotiate an FTA. Given the prevalence of socioeconomic preferences in this sector, such

negotiations could prove especially challenging.
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